INFORMATION CONTACT: Montana Office of Public Instruction (OPI)
Contacts: Rebecca Phillips (406) 444-0783
Janelle Graybeal (406) 444-3249
Kathleen Wanner (406) 444-9852

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

TYPE OF BOND ISSUES ALLOWED

1. Compliance Requirement:

- The trustees of a school district may issue general obligation bonds or impact aid revenue bonds for the following purposes:
  a. Building, altering, repairing, buying, furnishing, equipping, purchasing lands for, or obtaining a water supply for a school, teacherage, dormitory, gymnasium, other building, or combination of buildings for school purposes;
  b. Buying a school bus or buses;
  c. Providing the necessary money to redeem matured bonds, maturing bonds, or coupons appurtenant to bonds when there is not sufficient money to redeem them;
  d. Providing the necessary money to redeem optional or redeemable bonds when it is for the best interest of the school district to issue refunding bonds;
  e. Funding a judgment against the district, including the repayment of tax protests lost by the district; or
  f. Funding a debt service reserve account that may be required for impact aid revenue bonds. (MCA 20-9-403)

- Money realized from the sale of bonds issued on the credit of a high school district may not be used for any of the purposes listed above in an elementary school district, and the money may be used for any of the purposes above for a junior high school but only to the extent that the 9th grade of the high school is served. (MCA 20-9-403)

(**Note**: In issuing of *General Obligation Bonds* the school district has pledged its full faith, credit, and taxable resources for the repayment of the bonds with interest according to the terms of the bonds. The issuance of *Impact Aid Revenue Bonds*, however, does not constitute a general obligation of the school district and thus the school district's taxing power is not pledged for the repayment of said bonds. (MCA 20-9-437))

Suggested Audit Procedure:

- Review documentation on file and minutes of board meetings to determine that bonds were issued for only those purposes listed above. **(Note: See also Compliance Requirement No. 17 – INTERCAP)**

ISSUING BONDS

2. Compliance Requirements: **Bond Election**

- A school district shall not issue bonds for any purpose other than for refunding existing bond issues (MCA 20- 9-412) or for providing funds to repay taxes paid under protest (MCA 15-1-402) unless the issuance of the bonds has been authorized by the qualified electors of the school district at an election called for the purpose of considering a proposition to issue such bonds. (MCA 20-9-421)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ISSUING BONDS - continued

2. Compliance Requirements - continued:

- The question of whether or not to issue bonds can be submitted to the electorate after (1) the board of trustees has adopted a resolution to that effect; or (2) the trustees have received a petition asking that such election be held. (MCA 20-9-421)

- Any petition for the calling of an election must be signed by not less than 20% of the qualified voters within the school district, and must be validated by the county election administrator. (MCA 20-9-425)

- The school bond proposition shall be deemed to have been approved if:
  1. 40% or more of the qualified electors vote on the bond issue and a majority of the votes are in favor of the proposition, or
  2. more than 30% but less than 40% of the qualified electors vote on the bond issue and 60% or more of the votes are in favor of the proposition.

  Otherwise, the proposition shall be deemed to have been rejected. (MCA 20-9-428)

  For school district bond elections held on or after April 28, 2005, the above determination if the approval or rejection of the bond proposition applies if the election was held at a regular school election or at a special election called by the trustees (MCA 20-9-428(1)(a)). If the school district bond election is held at a general election, at an election that is conducted by mail ballot, or at a special election that is held in conjunction with a regular or primary election, the determination of the approval or rejection of the bond proposition is made by a majority of the votes cast on the issue (MCA 20-9-428(1)(c)).

- A school district may issue bonds by an adopted resolution of the trustees without an election for the following purposes:
  1. Refunding bonds – The resolution must state the reasons for issuing the new bonds, and setting forth the facts regarding the outstanding bonds that are to be redeemed and the terms and details of the new bond issue. (MCA 20-9-412(1))
  2. Intermediate Term Capital Program (INTERCAP) (MCA 20-9-471) **(Note: See Compliance Requirement No. 17 pertaining to INTERCAP loans.)**
  3. Bonds issued by the district for the purpose of deriving revenue for the repayment of tax protests lost by the district (MCA 15-1-402(7)(c))

- The issuance of bonds or notes for the purposes of funding a self-insurance or deductible reserve fund may be authorized by resolution of the board of trustees. (MCA 2-9-211)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ISSUING BONDS - continued

Suggested Audit Procedures:

- If the school district issued bonds during the audit period, review documentation on file and the minutes of board meetings to determine that the question of issuing the bonds was submitted to the electorate by resolution initiated by the governing body, or by resolution initiated by a petition signed by not less than 20% of the qualified voters of the district.

- Review the election results and determine that the issuance of the bonds was properly approved by the voters, as described above.

- If bonds were issued by resolution of the trustees during the audit period without an election, determine that they were issued for one of the allowable purposes described above.

- If refunding bonds were issued, review the minutes of board meetings to determine that the trustees adopted a resolution regarding the issuance of refunding bonds and verify that the resolution contain all of the elements describe above.

3. **Compliance Requirements:** **Elements of the Resolution**

- If the voters approve the issuance of the bonds, a resolution must be adopted by the trustees that sets forth the specific terms of the bonds. The resolution must specify: (1) the number of series or installments in which the bonds are to be issued; (2) the amount of bonds to be issued; (3) the minimum purchase price of the bonds; (4) the purpose or purposes of the issue; (5) the date that the issue will bear; (6) the period of time through which the issue will be paid; (7) the manner of execution of the bonds; (8) whether bids will be accepted for either serial or amortization bonds and, if so, the denomination of serial or amortization bonds; (9) the date and time that the sale of the bonds must be conducted; and (10) the minimum price fixed by the board of trustees for the bonds, which may not be less than 97% of the principal amount of the bonds if the board determines that the sale is in the best interests of the district. (MCA 20-9-429)

- Notice of the sale of the bonds must be published once a week for two consecutive weeks preceding the sale. (MCA 20-9-430 and 431)

Suggested Audit Procedures:

- Obtain a copy of the resolution and determine that it contains required information.

- Review documentation on file to verify that notification of the sale of the bonds was published as required.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BOND MINIMUM PRICE

4. **Compliance Requirements:**
   - The school district may fix the minimum price for the bonds in an amount not less than 97% of the face value if the board of trustees determines that the sale is in the best interests of the district. (MCA 20-9-429)

   - The bonds may not be sold by a district at less than the minimum sale price with accrued interest to date of delivery. (MCA 20-9-432)

   - The trustees are authorized to reject any bids and to sell the bonds at private sale if they consider it in the best interests of the school district. (MCA 20-9-432)

   Suggested Audit Procedure:
   - If bonds were issued during the audit period, review documentation on file related to the bond sale and determine that the bonds were not sold
     a. for less than 97% of the face value of the bonds, and
     b. at less than the minimum bid specified for their sale with accrued interest to the date of delivery.

BOND REGISTER

(Note: May not apply to registered bonds issued after July 1, 1983.)

{Registered bonds differ from “bearer bonds” in that bearer bonds are traded without a record of ownership. Ownership is maintained by having physical custody of the bond. With registered bonds the bond ownership is recorded and the certificate usually shows the name of the owner. In 1982, the US Internal Revenue Service outlawed the issuance of “bearer bonds”. }

5. **Compliance Requirements:**
   - When the school district bonds have been executed by the presiding officer of the trustees and the school district clerk, the bonds must be registered by the county treasurer in the treasurer's bond registration book before the bonds are delivered to the purchaser. The bond registration must show: (MCA 20-9-434)
     (a) the date of issue;
     (b) the redeemable date of each bond; and
     (c) the amount and due date of all payments required on the bonds.

     (**Note**: Prior to 4/13/95, the bond register was also required to show the number and amount of each bond, and the name and address of the purchaser.)

   - The trustees are also required to provide the county treasurer with an unsigned and canceled printed specimen copy of each issue of school district bonds for preservation in the office of the county treasurer. (MCA 20-9-434)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BOND REGISTER – continued:

Suggested Audit Procedure:

- Obtain confirmation from the county treasurer that a school district bond register is maintained for the school district under audit and that it contains all the elements as noted above. (**Note:** The bond register may be reviewed first-hand at the county treasurer's office, if the auditor reviews the redeemed warrants of the school district at the County, as recommended in SD-4 & SD-5)

BOND PAYMENTS

6. **Compliance Requirements:**

- School district bond issue redemption dates should coincide as nearly as possible with the largest monthly tax collections date, typically some day in June or December. The failure to date such bonds in June or December shall not affect their validity. (MCA 20-9-411)
  (**Note:** The bonds may be dated back not more than 5 months from the time of the actual sale, but no interest shall be charged on these bonds before they have been delivered to the purchaser and payment has been made by the purchaser. Interest accrued on such bonds according to their terms at the time of delivery shall either be refunded by the purchaser or deducted from the first interest payments.)

- The school district shall provide the county treasurer with a general obligation bond or impact aid revenue bond debt services schedule. (MCA 20-9-440)

- The county treasurer shall promptly notify the clerk of the school district when interest and principal payments have been made on bond issues. (MCA 20-9-442)

- A school district may use up to 25% of its federal impact aid funds received pursuant to 20-9-514 for repayment of general obligation bonds. (MCA 20-9-437)

Suggested Audit Procedures:

- Review the clerk of the school district debt files to determine
  1. if the redemption dates coincide with the dates as described above, and
  2. if the county treasurer has provided notice to the district when bond interest and principal payments have been made.

- Determine if any general obligation bond payments were made from the Impact Aid fund. If any, verify that the payment did not exceed 25% of the impact aid funds received during the audit period.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BOND PAYMENTS – continued:

7. **Compliance Requirement:** **Impact Aid Revenue Bonds**

Effective for bonds authorized on or after April 24, 2003

- Impact aid revenue bonds must be payable solely from the federal impact aid basic support payment received by the school district and deposited to the credit of the impact aid fund established in 20-9-514 and do not constitute a general obligation of the school district. (MCA 20-9-437)

Suggested Audit Procedure:

- Determine if the district has any impact aid bonds. If so, verify that the bond principal and interest payments came from only the federal impact aid basic support payment received by the school district

CLOSING ACCOUNTS & TRANSFERS TO OTHER FUNDS

8. **Compliance Requirement:**

- When all of the bonds and bond interest and special improvement district obligations of a school district have been fully paid, all money remaining in the debt service fund for the school district and all money that may come into the debt service fund from the payment of the delinquent taxes must be transferred to the building reserve levy fund, the technology acquisition and depreciation fund, or the general fund as designated by the school district, provided that the subsequent use of the funds by the school district is limited to constructing, equipping, or enlarging school buildings or purchasing land needed for school purposes in the district. (**Note**: Any federal impact aid funding remaining in the debt service fund of a school district that has fully repaid the bonds and bond interest must revert to the district's impact aid account.)
(MCA 20-9-443)

Suggested Audit Procedures:

- If all bond principal and interest have been fully paid, verify that any cash balance remaining in the debt service fund has been transferred to the general fund or other fund as described above, and that the debt service fund has been closed out.

- Verify that moneys which have come in for the debt service fund from the payment of delinquent taxes are distributed as designated by the school district trustees to the building reserve levy, technology acquisition and depreciation, or general funds.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BOND INTEREST RATES

9. Compliance Requirements:

- The interest rate of the bonds is to be determined by the trustees and must be paid semiannually. (MCA 20-9-410 & 17-5-102)

- The interest rate on refunding bonds must be at least ½ of 1% less than the refunded bonds. (MCA 20-9-412(3))

Suggested Audit Procedures:

- From a review of the minutes of board meetings, and from a review of documentation on file, verify that the interest rates for school district bonds are the same rates as set by the trustees at the time of bond issuance.

- Verify that interest payments are made semiannually on all bond issues.

- Verify that the interest rate on any refunding bonds is at least ½ of 1% less than the interest rate on the refunded bonds.

REFUNDING BONDS

10. Compliance Requirement:

- If a refunding bond issue refunds only a portion of an outstanding bond issue, the unrefunded portion of the outstanding bond issue and the refunding bond issue must be treated as a single bond issue. (MCA 20-9-412(4))

Suggested Audit Procedure:

- Determine if any refunding bond issues refunded only part of the outstanding bond issue. If so, verify that the district treats the outstanding bond issue and the refunding bond issue as a single bond issue.

11. Compliance Requirement:

- Refunding bonds may be issued in a principal amount greater than the principal amount of the outstanding bonds if there is a reduction of total debt service cost to the district. (MCA 20-9-412(5))

Suggested Audit Procedure:

- Determine if there were any refunding bonds issued for which the principal amount of the refunding bonds was greater than the principal amount of the outstanding bonds. If so, determine that the issuance of the refunded bonds results in a reduction of total debt service costs to the district.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

REFUNDING BONDS – continued

12. Compliance Requirement:

- Refunding bonds may be issued to refund outstanding bonds in advance of the date on which the bonds mature or are subject to redemption, provided the proceeds from the refunding bonds, less any accrued interest or premium received upon the sale of the bonds, are deposited with other funds appropriated to the payment of the outstanding bonds in escrow with a suitable banking institution. The funds must be invested in securities that are general obligations of the United States or the principal and interest of which are guaranteed by the United States. The securities should mature or be callable at the option of the holder on the dates and bear interest at the rates and payable on the dates required to provide funds sufficient, with any cash retained in the escrow account, to pay when due the interest to accrue on each refunded bond to its maturity or redemption date, if called for redemption, to pay the principal of the bond at maturity or upon the redemption date, and to pay any redemption premium. The escrow account must be irrevocably appropriated to the payment of the principal of and interest and redemption premium, if any, on the refunded bonds. (MCA 20-9-412(6))

  (**Note:** Effective July 1, 2003 – If the funds initially deposited in escrow are sufficient, without regard to any investment income on those funds, to redeem in full the bonds being refunded as of their redemption date and to pay the principal of and interest and premium on the bonds being refunded at their stated maturities, the funds may be invested in the securities described above or in a money market fund that is composed exclusively of eligible securities described in MCA 7-6-202, pertaining to investment of public money in direct obligations of United States.)

Suggested Audit Procedures:

- If refunding bonds have been issued during the audit period to refund outstanding bonds in advance of when such bonds mature or are subject to redemption, review bond files and minutes of board meetings.

- Verify that the bond proceeds are properly deposited in an escrow account, invested as provided above, and irrevocably appropriated for the payment of principal and interest on the refunded bonds.

BONDS ISSUED FOR JUDGMENTS

13. Compliance Requirement:

- School Districts may issue bonds to satisfy judgments rendered against the district by a court of competent jurisdiction including repayment of tax protests lost by the district. Property taxes may be levied to amortize bonds. (MCA 20-9-403 & 2-9-316)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

BONDS ISSUED FOR JUDGMENTS – continued:

Suggested Audit Procedure:

- If the district issued bonds during the audit period to fund a judgment, determine that the judgment was rendered against the district by a court of competent jurisdiction and the property taxes were levied to amortize the bonds as described above.

TERM OF BONDS

14. Compliance Requirement:

- School district bonds may not be issued for a term longer than 20 years. An exception to this is that bonds issued to refund or redeem outstanding bonds may not be issued for a term longer than 10 years unless the unexpired terms of the bonds to be refunded or redeemed is in excess of 10 years, in which case the refunding or redeeming bonds may be issued for the unexpired term. (MCA 20-9-410)

Suggested Audit Procedure:

- Determine that the terms of any school district bonds issued do not exceed the limitations described above.

REDEMPTION OF BONDS

15. Compliance Requirements:

- For bonds issued prior to April 28, 2005: All bonds issued for a term longer than 5 years must be redeemable at the option of the district on any interest payment date after one-half of the term for which they were issued has expired, and it must be so stated on the face of the bonds. (MCA 20-9-410)

- For bond issued on or after April 28, 2005: <u>Other than refunding or redeeming bonds, all bonds issued for a longer term than 5 years must be redeemable at the option of the school district on any interest payment date after one-half of the term for which they were issued has expired, and the redemption option must be stated on the face of the bonds.</u>

- Whenever there is a sufficient amount of money in the debt service fund available to pay and redeem one or more bonds which are redeemable on the next interest due date, the county treasurer is to give notice to the holder of the bonds, or to any bank or financial institution at which the bonds are payable, that the bonds will be paid and redeemed on such date. This notice is to be given at least 30 days before the next interest due date, and if the bonds are not presented for payment and redemption on the interest due date, the accrual of interest shall cease. (MCA 20-9-441(1) and (2))

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

REDEMPTION OF BONDS – continued:

- Whenever there is a sufficient amount of money in the debt service fund available to pay and redeem one or more bonds which are **not** yet due or redeemable, the trustees may direct the county treasurer to purchase such bonds if this can be done at not more than par and accrued interest, or at a reasonable premium not exceeding 6%. If this cannot be done, the excess money must be invested until required for the payment of the bonds. (MCA 20-9-441(3) and (4))

Suggested Audit Procedures:

- If the district issued bonds during the audit period, review a copy of the bond and determine that it clearly indicates that the bonds are redeemable at the option of the district as noted above.

- Review cash balances in the debt service fund throughout the audit period. If there was cash in excess of that needed to meet current bond principal and interest payments, determine if there was sufficient cash to redeem or buy one or more bonds as provided above.

- If there was sufficient cash, determine if bonds were redeemed or purchased as provided above.

- If not, verify that the excess funds were invested.

MAXIMUM BONDED INDEBTEDNESS

(**Notes to auditor:** (1) Usually the determination of whether or not a district is in compliance with the debt limitations should be made prior to the time the new indebtedness is incurred. A subsequent drop in taxable value in later years would not place the district in noncompliance. (2) For legal compliance testing, the debt limitation determination should be based on the laws in effect when the district last incurred new bonded debt.

16. Compliance Requirements:

- **For districts with a district mill value per ANB greater than or equal to the corresponding statewide mill value per ANB -**

  1. **Elementary District Or A High School District -** The maximum amount for which an elementary or high school district may become indebted by the issuance of general obligation bonds, including all indebtedness represented by outstanding general obligation bonds of previous issues, registered warrants, outstanding obligations under 20-9-471 and 20-9-502, and any other loans or notes payable that are held as general obligations of the district, building reserves, and the

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

MAXIMUM BONDED INDEBTEDNESS - continued

16. Compliance Requirements – continued:

principal amount of loans from the State Board of Investments, is 45% (effective July 1, 2007: 50%) of the taxable value of the property subject to taxation, as ascertained by the last assessment for state, county, and school taxes previous to the incurring of the indebtedness. (MCA 20-9-406(1)(a), 20-9-502(2) and (5)(d), and 20-9-471(7))

2. **K-12 School District -** The maximum amount for which a K-12 district may become indebted by the issuance of general obligation bonds, including all indebtedness represented by outstanding general obligation bonds of previous issues, registered warrants, outstanding obligations under 20-9-471 and 20-9-502, and any other loans or notes payable that are held as general obligations of the district, building reserves, and the principal amount of loans from the State Board of Investments, is up to 90% (effective July 1, 2007: 100%)of the taxable value of the property subject to taxation, as ascertained by the last assessment for state, county, and school taxes previous to the incurring of the indebtedness. The total indebtedness of the high school district with an attached elementary district is limited to the sum of 45% (effective July 1, 2007: 50%) of the taxable value of the property for elementary school program purposes and 45% (effective July 1, 2007: 50%) of the taxable value of the property for high school program purposes. (MCA 20-9-406(1)(b) & (c)) and 20-9-471(7))

- **For districts with a district mill value per ANB that is less than the corresponding statewide mill value per ANB –**

1. **Elementary District Or A High School District –** The maximum amount for which an elementary district or high school district with a district mill value per elementary ANB or per high school ANB that is less than the corresponding statewide mill value per elementary ANB or per high school ANB may become indebted by the issuance of general obligation bonds, including all indebtedness represented by outstanding general obligation bonds of previous issues, registered warrants, outstanding obligations under 20-9-471 and 20-9-502, and any other loans or notes payable that are held as general obligations of the district, building reserves (see MCA 20-9-502(2)), and the principal amount of loans from the State Board of Investments, is 45% (effective July 1, 2007: 50%) of the corresponding statewide mill value per ANB times 1,000 times the ANB of the district (See 20-9-471). (MCA 20-9-406(1)(d,) MCA)
2. **K-12 School District -** The maximum amount for which a K-12 district may become indebted is 45% (effective July 1, 2007: 50%) of the sum of the statewide mill value per elementary ANB times 1,000 times the elementary ANB of the district and the statewide mill value per high school ANB times 1,000 times the high school ANB of the district. (MCA 20-9-406(1)(d,) MCA)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

MAXIMUM BONDED INDEBTEDNESS – continued

16. Compliance Requirements – continued:

- If mutually agreed upon by the affected districts, for the purpose of calculating its maximum bonded indebtedness under this provision of law, a district may include the ANB of the district plus the number of students residing within the district for which the district or county pays tuition for attendance at a school in an adjacent district. The receiving district may not use out-of-district ANB for the purpose of calculating its maximum indebtedness if the out-of-district ANB has been included in the ANB of the sending district pursuant to the mutual agreement. (MCA 20-9-406(1)(d)) (**Note:** effective July 1, 2007, For the purpose of calculating ANB under this subsection, a district may use the greater of the current year ANB or the 3-year ANB calculated under MCA 20-9-311.)

- The maximum amount of impact aid revenue bonds that an elementary district, high school district, or K-12 school district may issue may not exceed a total aggregate amount equal to three times the average of the school district's annual federal impact aid basic support payments for the 5 years immediately preceding the issuance of the bonds. However, at the time of issuance of the bonds, the average annual payment of principal and interest on the impact aid bonds each year may not exceed 35% of the total federal impact aid basic support payments of the school district for the current year. (MCA 20-9-406(3))

- The maximum amount of the indebtedness determined by the above compliance requirements does not pertain to indebtedness imposed by special improvement district obligations or assessments against the school district or to general obligation bonds issued for the repayment of tax protests lost by the district (MCA 20-9-406(2)).

- Also, these debt limitations do not apply to bonds or notes issued for purposes of funding a self-insurance or deductible reserve fund (MCA 2-9-211(5)), or to short-term obligations issued in anticipation of taxes or revenues (MCA 7-6-1102 and 7-6-1115).

- Obligations issued and sold to the board of investments per MCA 20-9-471, (INTERCAP), **are** subject to the debt limitations. (MCA 20-9-471(7)) **(See Compliance Requirement No. 17 for additional information pertaining to INTERCAP)**

- In a school district within which a new major industrial facility that seeks to qualify for taxation as class five property under MCA 15-6-135 is being constructed or is about to be constructed, the school may enter into an agreement with the owners of the facility concerning the issuance of bonds in excess of 45% (effective July 1, 2007: 50%). Under such an agreement the school district may, with the approval of the

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

MAXIMUM BONDED INDEBTEDNESS – continued

16. Compliance Requirements – continued:

voters, issue bonds that exceed the 45% (effective July 1, 2007: 50%) limitation. The limitation may be exceeded by a maximum of 45% (effective July 1, 2007: 50%) of the estimated taxable value of the facility. The owners of the new facility must pay, in addition to the taxes imposed by the school district on property owners generally, the principal and interest on the bonds that are in excess of the 45% (effective July 1, 2007: 50%) limitation. (MCA 20-9-407)

Suggested Audit Procedure:

- Determine the total amount of bonds and registered warrants outstanding and the total amount of building reserves and State Board of Investment loans. Determine the taxable value as specified in the above statutes. Compare the taxable value to the total bonds and registered warrants outstanding and building reserves to determine if the district's indebtedness is within the debt limitations described above.

INTERMEDIATE TERM CAPITAL PROGRAM (INTERCAP)

17. Compliance Requirements:

- Intermediate Term Capital Program (INTERCAP) - The trustees may, without a vote of the electorate, issue and sell to the State Board of Investments obligations for the purpose of financing all or a portion of the following:
  a. the costs of vehicles and equipment;
  b. the costs associated with renovating, rehabilitating, and remodeling facilities, including but not limited to roof repairs, heating, plumbing, and electrical systems;
  c. Any other expenditure the district is otherwise authorized to make, including the payment of settlements of legal claims and judgments. However, the proceeds of these obligations may **not** be used to acquire real property or construct a facility unless:
     i. the acquisition or construction project does not constitute more than 20% of the square footage of the existing real property improvements made to a facility containing classrooms;
     ii. the 20% square footage limitation may not be exceeded within any 5-year period; and
     iii. the electors of the district approve a proposition authorizing the trustees to apply for funds through the State Board of Investments for the construction project.
  d. the costs associated with the issuance and sale of the obligations.

  (MCA 20-9-471)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

INTERMEDIATE TERM CAPITAL PROGRAM (INTERCAP) – continued:

17. Compliance Requirements - continued:

- The term of the INTERCAP obligation, including the obligation for a qualified energy project, may not exceed 10 fiscal years. (MCA 20-9-471)

- At the time of issuing the obligation, there must be a sufficient amount in the current fiscal year budget to make the debt service payment on the obligation coming due in the current year. (MCA 20-9-471)

Suggested Audit Procedure:

- Review documentation on file and minutes of board meetings to determine if the district incurred any INTERCAP obligations during the audit period. If so, verify that the obligations were issued for only those purposes described above.

USE OF BOND PROCEEDS

18. Compliance Requirements:

- All money realized from the sale of the bonds must be paid to the county treasurer, who shall credit the money to the building fund of the school district. However, money realized for accrued interest should be deposited in the school district's debt service fund. Also, if the bonds were issued to redeem matured bonds or coupons, or if refunding bonds were issued, bond proceeds should be deposited in the debt service fund. If the bonds were issued to fund a judgment against the district, including the repayment of tax protests lost by the district, bond proceeds should be deposited into a separate fund. (MCA 20-9-435(3))

- The trustees may expend the bond proceeds without budget authorization, but may expend the money only for the purposes for which the bonds were authorized by the bond election. (MCA 20-9-435(3))

- Any money realized by the sale of bonds and remaining to the credit of the building fund after the full accomplishment of the purpose for which the bonds were sold must be transferred to the debt service fund to be used for the redemption of the bonds. (MCA 20-9-508(3))

Suggested Audit Procedures:

- Based on a review of the county treasurer's reports to the school district, determine that bond proceeds received during the audit period, including accrued interest, if applicable, were deposited to the appropriate funds as noted above.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

USE OF BOND PROCEEDS – continued:

Suggested Audit Procedures - continued:

- Test selected expenditures made with bond proceeds to verify that expenditures were made only for the purposes authorized by the bond election.

- If the purpose of the bond issue has been fully accomplished during the audit period, review county treasurer's reports and other communications between the county and school district to verify that excess moneys were transferred to the debt service fund.

DEBT SERVICE FUND BUDGET

19. Compliance Requirement:

- The debt service fund budget must include:
  1. an amount necessary to pay the interest and principal becoming due during the ensuing fiscal year for each series or installment of general obligation bonds;
  2. an amount necessary to pay any special improvement district assessments levied against the school district which become due during the ensuing fiscal year; and
  3. a limited operating reserve for the purpose of paying debt service fund warrants and bond obligations that must be paid from July 1 through November 30 of the fiscal year following the ensuing fiscal year. (MCA 20-9-438)

Suggested Audit Procedure:

- Review the debt service fund budgets for the fiscal year being audited and for the ensuing fiscal year. Determine if the trustees have included sufficient amounts in the budget to pay all bond principal and interest and special improvement assessments. If the district has bond obligations (not paid or accrued) which become due from July 1 through November 30, verify that the trustees have included a limited operating reserve within the budget to provide for these payments. However, if a bond payment due from July 1 to Nov 30 has been paid or accrued in the prior fiscal year, no operating reserve should be allowed.

SCHOOL BUS INSTALLMENT CONTRACT

20. Compliance Requirement:

- Trustees may purchase a school bus under an installment contract. The term of the contract may be no more than 3 years. (MCA 20-10-110)
  (**Note:** The trustees may also purchase a school bus without advertising for bids under the provisions of MCA 20-9-204)

Suggested Audit Procedure:

- If a school bus was purchased under an installment contract, verify that the term of the contract is no more than 3 years.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

TAX, REVENUE, OR BOND ANTICIPATION NOTES (SHORT- TERM DEBT)

21. Compliance Requirements: Issuance and sale of short-term obligations

- Districts may sell short-term obligations in anticipation of taxes or revenues to be received during the fiscal year in which the obligations are issued. The proceeds must be solely expended for the purposes for which the taxes or revenues were appropriated and for costs related to the sale of the notes. (MCA 7-6-1102)

- For purposes of this discussion, short-term obligations are tax or revenue anticipation notes that mature at a time not to exceed 13 months from the date issued. (MCA 7-6-1101)

- The principal and interest on the notes must be repaid from the taxes and revenues in anticipation of which they were issued, income from investment of the proceeds of the obligations, and any money otherwise legally available for this purpose. (MCA 7-6-1102)

- The issuance of tax or revenue anticipation notes must be authorized by an ordinance or resolution that fixes the maximum amount of the obligation, the maximum amounts that may be outstanding, the maximum term and interest rate or rates, the manner of the sale, the maximum price, the form of the obligations including bearer or registered, the terms, the conditions and the covenants of the obligations. (MCA 7-6-1103)

Suggested Audit Procedures:

- If tax or revenue anticipation notes (short-term obligations) were issued during the audit period, review a copy of the ordinance or resolution authorizing their issuance and determine that it includes the items listed above.

- Test expenditures to determine that the proceeds were used for the purposes for which the taxes or revenues were appropriated, and for costs and expenses related to the issuance and sale of the notes.

- Determine that the payments of principal and interest on the notes were made from the receipt of the anticipated taxes and revenues, or from other allowable sources noted above.

22. Compliance Requirement: Refunding and renewal

- Tax or revenue anticipation notes (short-term obligations) may be renewed or refunded, but may not be renewed or refunded to a date later than 6 months from the end of the fiscal year in which the original short-term obligation was issued. (MCA 7-6-1105)

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

TAX, REVENUE, OR BOND ANTICIPATION NOTES (SHORT- TERM DEBT – cont.

Suggested Audit Procedure:

- If tax or revenue anticipation notes (short-term obligations) have been renewed or refunded, determine that the new payable date was not later than 6 months from the end of the fiscal year in which the original short-term obligation was issued.

23. Compliance Requirements: **Sale of Notes in Anticipation of Grants, Loans, or Sale of Bonds**

- The board of trustees may by resolution issue and sell notes in anticipation of the receipt of a state or federal grant or loan, or the sale of bonds. The amount of the notes may not exceed the total amount of bonds authorized and maturing within not more than 3 years from the date on which the notes are issued. Before the notes are issued, the district must receive a written commitment for a grant, loan, or bond purchase in an amount that is not less than the principal amount of the notes. (MCA 7-7-109(2))

- The proceeds of the grant, loan, or bonds must be credited to the debt service fund for the notes as may be needed for their payment, with interest, when due. (MCA 7-7-109(3))

Suggested Audit Procedures:

- If revenue or bond anticipation notes were issued during the audit period, determine that the district had received a written commitment for a grant, loan, or bond purchase in an amount at least equal to the principal amount of the notes. Determine that the amount of the notes did not exceed the amount of bonds authorized and maturing within not more than 3 years of the issuance date of the notes.

- Determine that the proceeds of the grant, loan, or bonds were credited to the debt service fund established for the notes, as needed for the notes' repayment, with interest.

QUALIFIED ZONE ACADEMY BONDS (QZAB)

QZAB Overview:

The Qualified Zone Academy Bond Program (a financial instrument) was created to provide no-interest financing for renovating and repairing school buildings, purchasing equipment including up-to date technology, developing curricula, and/or training school educators'. *New construction, however, does not qualify.* The QZAB is a Tax-Credit Bond Program and is not a grant program. (No Federal CFDA number assigned and does not appear to be considered a federal loan subject to OMB Circular A-133.) In Montana, the Board of Investments is a

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

QUALIFIED ZONE ACADEMY BONDS (QZAB)

QZAB Overview – continued:
financial institution that is authorized to issue QZAB. The school district is obligated to pay back the amount of money it initially borrows, but does not pay any interest on the outstanding debt.

24. **Compliance Requirements:**

- For a school district to be eligible for the QZAB they must meet all three of the following criteria:
  - Establish a partnership with a business to contribute not less than 10 percent of the net present value of the bond proceeds,
  - At least 35 percent of the students attending are eligible for free or reduced price lunches under the federal lunch program (National School Lunch), and
  - These low income students are subjected to the same academic standards and assessments as other students in the district.

- The 10 percent match of the business partner may take many forms including those noted below:
  - Cash,
  - Goods, including equipment and technology,
  - Services, including help developing curriculum or using technology,
  - Training for teachers,
  - Internships or field trips that provide opportunities for students to learn outside a traditional classroom setting, and/or
  - Other property or services specified by the local school board.

  In addition, the business partner works with the school district to set up an **academic program** "to increase graduation and employment rates, and better prepare students for college and the workforce under a plan approved by the local school system".

- The QZAB is accounted for on the school district's books as a long-term liability until the entire bond issue matures. The school district makes periodic payments to an escrow account. These payments plus interest earned on the escrow account are used to pay the loan in full at maturity. This unique financing situation should be fully disclosed in notes to the financial statements.

- Interest earnings in the escrow account are recorded as interest revenues in the accounting records of the school district in the period earned. The Cash With Fiscal Agent reported should equal the combined total of payments made to escrow plus interest earnings. No debt service expenditure is reported until the escrow account balance equals the outstanding debt balance, or at maturity. If at maturity the balance in the escrow account does not equal the loan balance the school district will need to use general fund moneys to make-up the difference.

COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

QUALIFIED ZONE ACADEMY BONDS (QZAB)

24. **Compliance Requirements - continued:**
{**Example –** In 2005, the School District issued $5,400,000 in Qualified Zone Academy Bonds (QZAB) to finance the purchase of computer technology for the classrooms. The School District will make seven annual payments, which are deposited into an escrow account that will earn an investment rate of 3.45%. The last payment is due in June 2011 for a total of $3.8 million. The remaining $1.6 million due will accrue as interest in the escrow account until the bonds mature in June 2018.}

Suggested Audit Procedures:

- If the school district has a QZAB, determine that at least 35% of students attending qualified for free or reduced lunch.

- Determine the form of the business partner match, and verify that it equals 10% of the QZAB. (**Note:** Probes into these bonds have revealed that there is a misuse of the 10% match, "by valuing a contribution above fair market.")

- Verify that the school district and the business partner have set up an academic program in the school. (**Note:** Probes into these bonds have revealed that the business partners did not set-up an academic program in the school district, as required.)

- Verify that the QZAB liability and the related interest earnings are accounted for and reported, as discussed above. (**Note:** The use of a debt service fund to account for the financial resources being accumulated (principle payments and interest earnings) for the principal payment that matures in the future complies with GAAP reporting standards. Cash transfers can be budgeted each fiscal year (in lieu of debt service expenditures).